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CORPORATION FILE

ZAYRE

ANNUAL REPORT 1966

ZAYRE

ANNUAL REPORT 1966

Financial Highlights

1966

1965

Net Sales	\$345,702,887	\$278,558,325
Net Income	8,109,612	6,656,325
Working Capital	34,010,160	29,028,025
Shareholders' Equity	36,790,164	23,746,510
Net Income Per Common Share	2.81	2.53

Message from Management

To Our Shareholders:

The achievements within 1966, the tenth anniversary of the Zayre retail concept, were by far the most significant of any year in our history, in all areas of our business.

Earnings reached a new record high in the fiscal year ended January 28, 1967, while at the same time the company maintained its strong new store expansion program, completed a number of major acquisitions, and very substantially enlarged its capital base.

Sales and Earnings

Results reflect record sales in our established Zayre stores and new store openings as well as operations acquired since our last annual report. The acquisitions of Hardlines Distributors on July 29, 1966, and Shoppers' City on March 31, 1967, have been treated for accounting purposes as poolings of interests. All financial data in this report has been adjusted to give retroactive effect to the operations of the businesses so acquired.

Total sales (excluding those of leased departments) reached \$345,702,887, up from \$278,558,325 in the prior year.

Net income increased to \$8,109,612 compared with \$6,656,325 in 1966. Earnings per common share rose to \$2.81 from \$2.53 last year. Per share earnings give effect to pro forma provision for dividends on our outstanding preferred stock and are based on the average number of shares of common stock outstanding in the period.

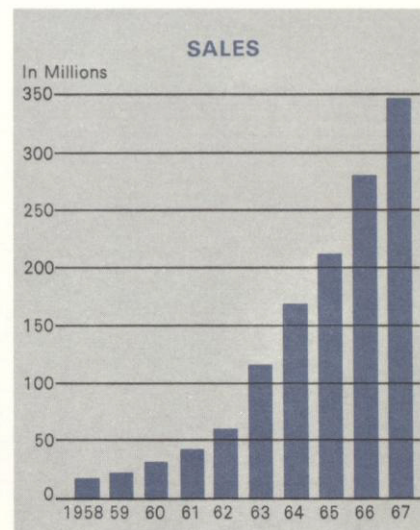
Perspective

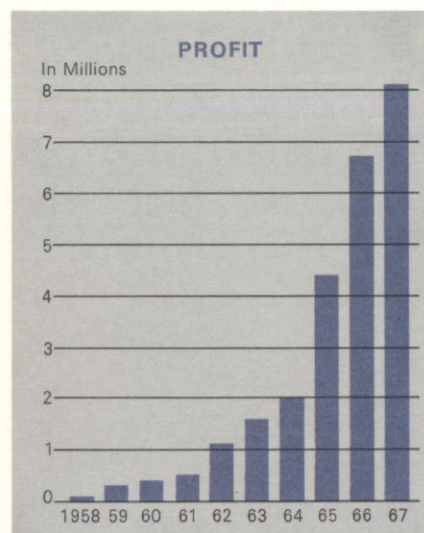
The pooling of interests treatment of our financial results, while necessary to present a proper historical comparison for statistical purposes, tends to obscure the true progress achieved under management's stewardship.

To fully appreciate the magnitude of the company's development during the past year, we have prepared the following table. It compares important financial data as originally reflected in our 1965 annual report, as restated to give retroactive effect to acquisitions on a pooling of interests basis, and for the year just ended:

<i>Fiscal Year Ended January</i>	<i>1966 As Reported Last Year</i>	<i>1966 As Restated For Poolings</i>	<i>1967 Current Results</i>	<i>% Increase 1967 Over 1966 Results As Reported Last Year</i>
Total Sales	\$222,166,330	\$278,558,325	\$345,702,887	56
Net Income	5,100,446	6,656,325	8,109,612	59
Net Income Per Common Share	2.15	2.53	2.81	31
Total Share- holders' Equity	18,325,134	23,746,510	36,790,164	101

Thus, during 1966 your company achieved the largest expansion of its sales base in its history. Most importantly, the growth of net income kept pace with sales.





Financial Position

Net working capital has grown to \$34,010,160 from \$29,028,025 at the end of last year. Your management is keenly aware of the importance of this factor in a rapidly expanding merchandising operation. By financing capital additions through its leasing subsidiaries, the company is able to utilize virtually all of its earnings and capital increments to expand its working capital position.

As previously reported, on March 14, 1966 the company issued a call for redemption of all outstanding 4 $\frac{5}{8}$ % convertible subordinated debentures, due May 1, 1985. This resulted in conversion of all the then outstanding debentures into 239,471 shares of common stock and an increase in shareholders' equity of approximately \$5,562,000 before certain related expenses.

The Hardlines acquisition was made for \$850,000 in cash and 463,636 shares of a new issue of Zayre series A cumulative convertible preferred stock. This resulted in an increase of \$4,403,260 in shareholders' equity as of the start of the year. This stock issue carries an annual dividend of 75 cents per share, payable quarterly.

Zayre acquired substantially all of the assets of Shoppers' City, Inc. in exchange for 129,350 shares of common stock. Although consummated after fiscal year end, the pooling of this transaction has been reflected in the current report so as to provide additional information to our stockholders.

This year's earnings represent a 27% return on average invested capital and continues Zayre's record of generating an above-average return on its shareholders' equity.

Expansion Continues

The dramatic enlargement of the company's volume base within the past year reflects the tremendous efforts of Zayre employees and executives throughout the organization.

Outside factors caused us to accelerate our plans for the development of owned health, beauty aid and candy departments. During April, 1966 we completed the purchase of the inventories of the 68 departments that had formerly operated as leased departments. Our buying and store operating staff in this division did a remarkable job of gearing up, in such a brief period, to service the merchandise requirements of so many additional departments. As a consequence of our initial emphasis on volume, major increases over prior period figures were achieved. We anticipate the realization of improved gross margins in these departments over the next several years as a result of improved merchandising controls and greater buying sophistication.

During this period, as a result of its acquisition of Hardlines Distributors, Inc., Zayre took over operation of leased houseware and hardware departments in all Zayre stores and, as a necessary incident thereto, similar operations in certain other self-service department stores.

Zayre-owned departments now account for approximately 87% of total Zayre store volume. The major departments presently operated by lessees include shoes, snack bar, fabric and yarn, and millinery.

During 1966 Zayre added a total of 13 new Zayre stores, so that at year end 92 such units were in operation. Zayre stores have an aggregate gross area of approximately 6,786,000 square feet.

The new Zayre stores opened in 1966 include 3 stores formerly operated by another retailer in the greater Miami, Florida area. We purchased the merchandise inventory and fixtures from the former operator and assumed the leases. A significant cost was absorbed during 1966 in turning this inventory over and changing to the Zayre operating format. However, these units increased to 10 the number operated in the greater Miami-Fort Lauderdale market and thereby achieved for Zayre the major position in discount retailing in one of the nation's most rapidly growing market areas.

Our new store program has been enlarged and contemplates the opening of 15 or more units in both 1967 and 1968. These stores will be located in the eastern half of the country with prime emphasis being given to those marketing areas in which we seek to intensify our coverage. Thus far in 1967 two new units have been opened with 5 additional units scheduled within the first half of the year. A highlight of this program will be the simultaneous opening during May of three new units in the greater Chicago area bringing to 12 the number of Zayre stores in that market.

Shoppers' City

This acquisition brings to Zayre four very large-volume discount department stores in Minneapolis, St. Paul and Duluth, Minnesota. All are 120,000 square feet or more in gross area and include not only a full range of general merchandise, but also company operated discount supermarkets. During the fiscal year ending January 28, 1967 the total volume of these stores was \$43,676,302, including leased department volume of \$13,573,468.

Shoppers' City will be operated as a separate division of Zayre. It will continue with the same executive staff and personnel, supplemented by the addition of several key executives from Zayre. We are pleased that Messrs. Melvin Roth and Seymour Rothstein, founders of Shoppers' City, have joined Zayre as President and Executive Vice President, respectively, of this division.

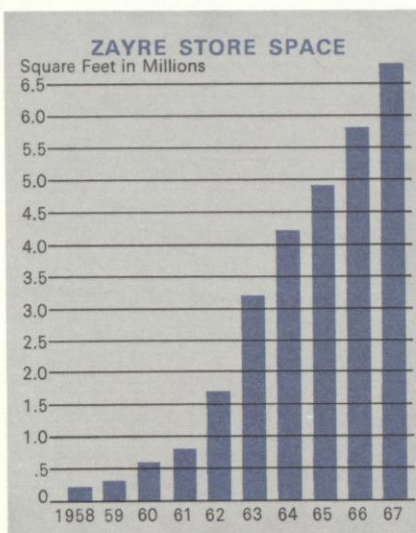
We anticipate that significant additional volume and profits will be generated from these stores over the years ahead. Many of the leased departments will be phased out and Zayre will assume their operation. We have already completed arrangements for a new store under the Shoppers' City name and operating format to be opened in the Minneapolis area in late 1967 or early 1968.

Other Developments

Our experience with the Zayre personalized credit card program has been encouraging. It is apparent that this customer service can account for a significant portion of store volume and enhance customer loyalty. Accordingly, during 1966 the program was extended to 23 units, making a total of 47 stores with full credit services available at year end.

Thus far in 1967 the program has been extended to most New England area stores, and by year end virtually all major Zayre markets will be offering this service.

Our rapid growth has necessitated the installation of a second IBM System 360 computer to supplement the one purchased in 1965. We have substantially enlarged our executive group in the systems area so that new, improved and more sophisticated computer procedures can be conceived, developed and placed in operation. Systems design in a dynamic company is a never-ending



routine in which procedures are refined in successive stages to keep pace with corporate growth.

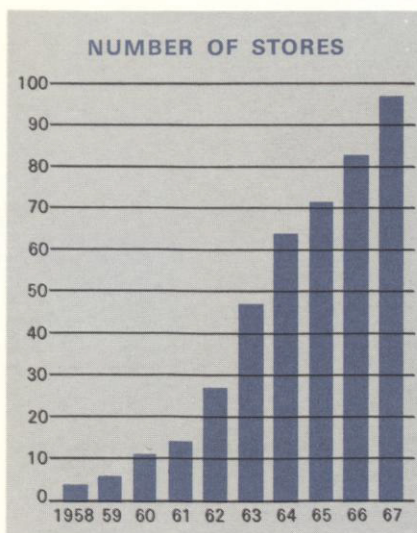
Our apparel specialty shops division operating under the names "Bell Shops" and "Nugents" achieved substantial progress in 1966. Both sales and profits showed increases. Two units were opened and three units closed, making a total of 40 apparel stores in operation. Due, however, to our emphasis on the Zayre stores, this division now accounts for less than 3% of total company sales.

In order to maintain a high level of service for our growing number of stores and volume of business, our central distribution facilities have been significantly enlarged. Our New York City fashion apparel distribution center has been doubled in size to 250,000 square feet. We have also doubled the size of our Framingham distribution center to 500,000 square feet. At Framingham we have also added 78,000 feet of office space, which we are about to occupy. This, together with our existing Natick office facility, will enable us to unify all of our home office functions and eliminate the use of two other small office buildings, which have been under short-term lease.

The number of our stores operated in the Midwest and South has caused us to start development of distribution procedures and store supervisory organization along regional lines. We are presently using four public warehouses in major cities as a first step in the ultimate development of our own regional distribution facilities.

As a result of the acquisition of Archer Sales Corp. in 1965 and Hardlines Distributors, Inc. in 1966, Zayre assumed the operation of a number of leased departments in other discount department stores. In December, 1966 one of these chains, in which Archer had originally operated 23 departments and was then operating 12, and in which Hardlines had operated 13 departments and was then operating 8, filed a petition under Chapter XI for voluntary bankruptcy.

Zayre acted promptly to minimize its losses and subsequently withdrew its merchandise. The pre-tax loss due to unpaid receivables, net of anticipated settlements, charged to 1966 earnings was \$153,500. In addition, the company experienced further costs in liquidating the inventories that had been removed. These transactions had the effect of reducing 1966 per share earnings by approximately 8 cents.



Zayre Realty Subsidiaries

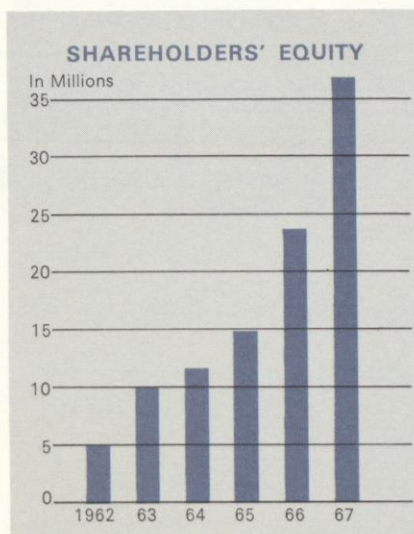
During 1966 our realty subsidiaries completed the acquisition and financing of two additional Zayre store properties in Fort Lauderdale, Florida and Indianapolis, Indiana, bringing to eight the number of such properties owned.

Subject to completion of construction and certain other contingencies we presently plan to purchase four additional store sites in 1967. These properties are located in Augusta and Waterville, Maine; Chicago (Ashland Ave.), Illinois; and Duluth, Minnesota.

This program of real estate ownership enables Zayre to achieve somewhat lower rentals and to retain for the corporation the residual equity remaining in the property after it has been fully depreciated.

Personnel

At the annual meeting in May, 1966 the stockholders elected Walter Salmon, Associate Professor of Marketing at the Harvard Graduate School of Business Administration, to our Board of Directors.



In recognition of the growing size and complexity of our business, a new senior officership level was created. Messrs. Sumner L. Feldberg, Burton S. Stern and Milton L. Levy were elected to the new position of Senior Vice President.

Mr. Paul Kwasnick, Assistant Treasurer, was advanced to Vice President. Messrs. Saul Leibow and Leo Michelson, formerly President and Treasurer, respectively, of Hardlines Distributors, Inc., were both elected Vice President — Housewares.

Mr. Norman Lenox, Assistant Secretary, and Theodore Schoenfeld, Senior Merchandise Manager, were both elected Assistant Vice President.

Outlook

As we all know, the nation's economy has been functioning at a somewhat softer pace since the middle of 1966. Opinions vary, but the consensus seems to be that this trend will continue through much of 1967, with a stronger tone to business setting in towards year end. Measured by historical standards, 1967 should be an above-average year for retailing as a whole, although not as dynamic in rate of growth as was 1965 and 1966.

The acceptance of self-service general merchandise stores as a form of retailing is no longer a subject of debate. The only question is what share of total consumer expenditures the industry will capture. Certainly, however, it is generally agreed that for some years to come self-service general merchandise stores will steadily increase their penetration of the market.

During 1967 your company will continue its strong new store opening program, primarily aimed at intensifying our coverage of the markets we serve. Continued emphasis will be placed on improving the profitability of our many new stores and merchandise departments.

At the conclusion of our tenth year, we pause a moment to look back at all that has been accomplished in such a short span of time. Within a few weeks a major advertising campaign will be launched in all market areas to celebrate the opening of the 100th Zayre store. Our volume has grown from \$18 million to \$345 million in that decade. Net income has increased from \$143,000 to \$8,109,000 and shareholders' equity has grown to \$36.8 million.

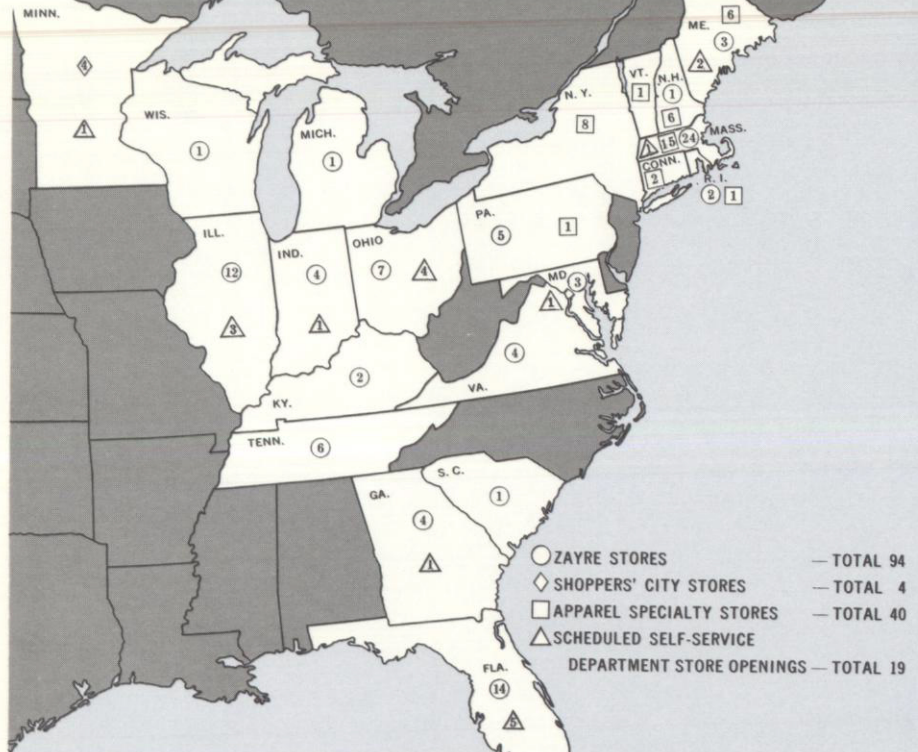
Great tribute must be paid to the dedication and devotion of the Zayre family of employees who now number over 12,000 people at store, warehouse, office and executive levels. Their experience and ability is our greatest asset for the future. To each and every one of them goes our thanks for their help in making Zayre what it is today.

Respectfully submitted,

MORRIS FELDBERG,
Chairman

STANLEY H. FELDBERG,
President

April 21, 1967



Zayre Corp. Stores

Zayre Stores (94)

Florida — **JACKSONVILLE** (2) Beach Blvd., Normandy Blvd. — **MIAMI** (10) Coral Way, Fort Lauderdale (2), Hialeah, North Miami Beach, Pompano Beach, 2nd Avenue, 7th Avenue, South Dixie Highway, West Hollywood — **TAMPA** (2) East Hillsborough, Gandy Blvd.

Georgia — **ATLANTA** (4) Buford Highway, Cascade Avenue, Smyrna, Stewart Avenue

Illinois — **CHAMPAIGN** — **CHICAGO** (9) Ashland, Bridgeview, Columbus Avenue, Des Plaines, Forest Park, Joliet, Markham, Oaklawn, Palatine — **ROCK ISLAND** — **SPRINGFIELD**

Indiana — **INDIANAPOLIS** (4) East 10th Street, North Tibbs Avenue, Pendleton Pike, South East Highway

Kentucky — **LOUISVILLE** (2) Bardstown Road, Dixie Highway

Maine — **BANGOR** — **PORTLAND** — **PRESQUE ISLE**

Maryland — **DISTRICT OF COLUMBIA** (3) Lanham, Silver Springs, Wheaton

Massachusetts — **BOSTON** (12) Beverly, Braintree, Cambridge, Dorchester, Medford, Natick, Revere, Roslindale, Roxbury, Saugus, Waltham, Woburn — **FALL RIVER** — **GREAT BARRINGTON** — **HADLEY** — **HYANNIS** — **LOWELL** — **METHUEN** — **PITTSFIELD** — **SPRINGFIELD** (3) Agawam, Boston Road, Chicopee — **WORCESTER** (2) Lincoln Street, Stafford Street

Michigan — **KALAMAZOO**

New Hampshire — **MANCHESTER**

Ohio — **CINCINNATI** (2) Paxton Avenue, Princeton Pike — **CLEVELAND** (3) North Olmsted, Ridge Road, Warrensville Heights — **COLUMBUS** (2) East Main Street, West Broad Street

Pennsylvania — **PITTSBURGH** (4) Baden, McKeesport, McKnight Road, Monroeville — **WILKES-BARRE**

Rhode Island — **PROVIDENCE** (2) East Providence, Silver Spring Street

South Carolina — **COLUMBIA**

Tennessee — **CHATTANOOGA** — **KNOXVILLE** — **MEMPHIS** (2) Poplar Avenue, Summer Avenue — **NASHVILLE** (2) Gallatin Road, Murfreesboro Road

Virginia — **DISTRICT OF COLUMBIA** (2) Alexandria, Falls Church — **PORTSMOUTH** — **RICHMOND**

Wisconsin — **RACINE**

Shoppers' City Stores (4)

Minnesota — **DULUTH** — **MINNEAPOLIS** (2) Brooklyn Center, St. Louis Park — **ST. PAUL**

Apparel Specialty Stores (40)

Connecticut — **NORWICH** — **THOMPSONVILLE**

Maine — **AUGUSTA** — **BIDDEFORD** — **LEWISTON** — **PORTLAND** — **ROCKLAND** — **SKOWHEGAN**

Massachusetts — **BOSTON** — **FALL RIVER** — **FRAMINGHAM** — **GLOUCESTER** — **LAWRENCE** — **LOWELL** — **LYNN** — **MALDEN** — **PITTSFIELD** — **QUINCY** — **SALEM** — **SPRINGFIELD** — **TAUNTON** — **WALTHAM** — **WORCESTER**

New Hampshire — **BERLIN** — **CONCORD** — **KEENE** — **MANCHESTER** — **NASHUA** — **ROCHESTER**

New York — **AUBURN** — **GLENS FALLS** — **JAMESTOWN** — **KINGSTON** — **NIAGARA FALLS** — **OLEAN** — **POUGHKEEPSIE** — **WATERTOWN**

Pennsylvania — **ERIE**

Rhode Island — **PAWTUCKET**

Vermont — **NEWPORT**

Store Openings Now Scheduled

ZAYRE STORES

Florida — **MELBOURNE** — **ORLANDO** (2) Lake Howell Road, South Orange Avenue — **LARGO** — **WEST PALM BEACH**

Georgia — **ATLANTA** (Candler Avenue)

Illinois — **CHICAGO** (3) Lombard, River Grove, West 26th and Whipple

Indiana — **HAMMOND**

Maine — **AUGUSTA** — **WATERVILLE**

Massachusetts — **ATTLEBORO**

Ohio — **CINCINNATI** — **CLEVELAND** (3) Brook Park, Elyria, Mentor

Virginia — **DISTRICT OF COLUMBIA** (Tysons Corner)

SHOPPERS' CITY STORES

Minnesota — **MINNEAPOLIS** (Columbia Heights)

TEN YEARS OF GROWTH

Ten-Year Summary of Progress

ZAYRE CORP. AND ALL SUBSIDIARIES

Fiscal Year Ended Last Saturday in January	1967	1966	1965	1964
OPERATING DATA: (2)				
Net sales, excluding sales of leased departments	\$345,702,887	\$278,558,325	\$211,984,918	\$167,846,772
Earnings before federal income taxes	\$ 14,409,612	\$ 11,656,325	\$ 7,482,061	\$ 3,252,011
Net income	\$ 8,109,612	\$ 6,656,325	\$ 4,369,611	\$ 1,993,277
Average number of common shares outstanding	2,764,684	2,502,820	2,483,869	2,483,450
Earnings per common share (1)	\$2.81	\$2.53	\$1.63	\$.67
STORES IN OPERATION: (2)				
Self-service department stores	96	83	72	64
Apparel specialty shops	40	41	43	46
FINANCIAL POSITION: (2)				
Current assets	\$ 69,970,686	\$ 55,771,000	\$ 36,235,800	\$ 33,110,766
Current liabilities	\$ 35,960,526	\$ 26,742,975	\$ 19,805,734	\$ 18,996,036
Working capital	\$ 34,010,160	\$ 29,028,025	\$ 16,430,066	\$ 14,114,730
Shareholders' equity	\$ 36,790,164	\$ 23,746,510	\$ 14,907,961	\$ 11,694,875
Number of common shares outstanding at year end	2,779,548	2,530,137	2,486,740	2,483,450
Equity per share (3)	\$12.46	\$8.78	\$5.67	\$4.38

1963	1962	1961	1960	1959	1958
\$115,850,773	\$59,165,743	\$41,942,064	\$31,372,742	\$22,001,541	\$18,516,155
\$ 2,622,428	\$ 2,003,736	\$ 1,062,697	\$ 903,148	\$ 517,338	\$ 201,776
\$ 1,561,428	\$ 1,126,736	\$ 541,697	\$ 441,148	\$ 295,338	\$ 143,776
2,190,766	2,109,100	2,109,100	2,109,100	2,109,100	2,109,100
\$.56	\$.53	\$.26	\$.21	\$.14	\$.07
47	27	14	11	6	4
48	52	59	61	64	70
\$ 21,891,016	\$11,467,893	<p>(1) Net income per common share is based on the average number of shares outstanding each year as retroactively adjusted for the preferred and common stock issued in connection with "poolings of interests", after pro forma recognition of the full \$347,727 dividend requirements on the shares of preferred stock.</p> <p>(2) Information reflects acquisitions on a "pooling of interests" basis for Shoppers' City, Inc. (1964-1967) and Hardlines Distributors, Inc. (1963-1967).</p> <p>(3) Information assumes full conversion of the 463,636 shares of preferred stock into 173,863 shares of common stock.</p>			
\$ 12,364,312	\$ 7,347,858				
\$ 9,526,704	\$ 4,120,035				
\$ 10,023,589	\$ 4,957,270				
2,354,100	2,109,100				
\$3.93	\$2.35				



The Indianapolis, Indiana store shown above

The Zayre Story—Ten Years of Growth

1966 marks the completion of ten years of growth and evolution for Zayre Corp. In June, 1956 the first Zayre self-service department store was opened in Hyannis, Massachusetts.

The next decade has seen Zayre expand rapidly across half the country. Today there are 94 Zayre department stores and 4 Shoppers' City stores located in 18 states. Company volume has increased from \$18,500,000 to \$345,700,000.

Zayre has accomplished this remarkable growth by satisfying the basic needs of the rapidly growing suburban population. The Zayre merchandising philosophy emphasizes two concepts—value and convenience. Value is reflected through the sale of first quality merchandise at the lower prices made possible by using self-service principles. Convenience is offered the suburban population by catering to their distinctively different shopping patterns, and by assembling wide assortments of popular priced merchandise, all under one roof.



The fashion apparel departments set the tone for the rest of the store and serve as an important attraction for women shoppers.

Zayre Offers Wide Variety of Merchandise

Zayre meets the apparel and home needs of middle income suburban families by supplying first quality merchandise at discount prices. The stores carry an extensive line of ladies' apparel including ready-to-wear, sportswear, lingerie and accessories; girlswear in all age ranges; men's and boys' apparel and furnishings, and shoes for the entire family. Customer home and recreational interests are satisfied by a broad variety of well stocked departments ranging from housewares, hardware, home appliances and domestics, to health and beauty aids, photographic equipment and supplies, toys and sporting goods.

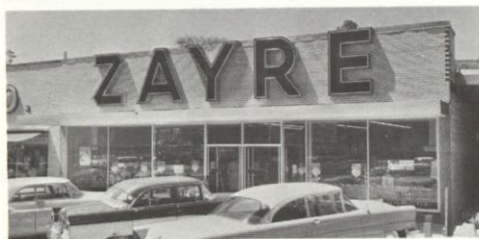


Scene above is typical in appearance of most new Zayre stores.

Customer Convenience Emphasized

Customers like the easy informality and convenience of shopping at Zayre stores. Convenience is emphasized in many ways . . .

- Customers serve themselves by wheeling shopping carts through wide aisles of merchandise, selecting items, and paying at check-out counters.
- Personalized charge accounts are available at most Zayre stores. Large appliances may be financed on conditional sales contracts. Layaway plans are also available.
- Zayre stores are open six days a week from 10:00 A.M. to 10:00 P.M., thus providing an opportunity for evening family shopping.
- Zayre stores are easy to get to since they are located on major highways. Plentiful free parking is available.
- Most Zayre stores are located in the same shopping center with, or adjacent to, food markets operated by important national or regional food chains.



Scenes above show the first Zayre store opened in 1956 and located in Hyannis, Mass. This unit, originally 5,000 square feet, has been enlarged to 75,000 square feet.

Prior Growth and Experience

Zayre Corp. traces its roots back to 1919 and the founding in Boston, Massachusetts of New England Trading Co. by Morris and Max Feldberg. This business prospered, and, in 1929, the Feldbergs opened their first retail store, then devoted primarily to selling ladies' hosiery.

Over the years the business evolved into a chain of apparel specialty stores. By 1955, 72 such stores were in operation, having a total volume of approximately \$14,000,000. At this time, a new retailing phenomenon — the discount house — emerged and became an important competitor of the established apparel, variety and supermarket chains.

Management quickly recognized the significance of this new development. In 1956 the first two experimental Zayre stores were opened and proved to be immediately successful.



In recent years the company has upgraded the apparel specialty stores operated under "Bell" and "Nugents" names. Typical new interior and exterior is shown above.

Zayre Growth

Zayre's remarkable record of growth in the short period of ten years is based upon the existence of an experienced chain store management. When Zayre moved into its first self-service department store in 1956, it had an organization skilled in buying fashion apparel (a prime traffic builder in discount stores), long experience in operating and controlling chain stores, plus a pool of managerial talent.

The following tabulation shows how well Zayre has taken advantage of the growth opportunities in the new field of self-service department stores.

Period Ended	Zayre Stores Opened	Zayre Stores in Operation at End of Period	Approximate Total Gross Area at End of Period
January 31, 1957	2	2	60,000
January 31, 1958	2	4	148,000
January 31, 1959	2	6	276,000
January 31, 1960	5	11	616,000
January 31, 1961	3	14	794,000
January 27, 1962	13	27	1,680,000
January 26, 1963	20	47	3,184,000
January 25, 1964	14	61	4,207,000
January 30, 1965	8	69	4,867,000
January 29, 1966	10	79	5,762,000
January 28, 1967	13	92	6,786,000

The chart does not include the four Shoppers' City units acquired on March 31, 1967, each of which is 120,000 square feet or more in size.

Central Distribution Facilities

Zayre is heavily committed to the economies of central distribution. We believe that this technique of merchandise distribution enables the rapid replenishment of store stocks, the maintenance of inventory at optimum levels, and the rapid opening of new stores.

Accordingly, we have three sizable distribution centers. Two are in the Boston area (Natick and Framingham) and the third in midtown New York City. Each center concentrates on a homogeneous line of merchandise and has its own staff of skilled merchandisers and distribution experts.

In order to cope with the increased size of the chain, we recently added 250,000 feet of additional space to the Framingham, Massachusetts facility and 125,000 feet of additional space to the New York City facility. In all, the company operates approximately 850,000 square feet of distribution space.

Supplementing these owned facilities are four public warehouses located in Chicago, Illinois; Columbus, Ohio; Atlanta, Georgia and Miami, Florida. This wide ranging network of facilities enables Zayre to move merchandise on an economic basis.

Management Information and Systems Division

We have invested heavily in a sophisticated computer installation and a staff of data processing experts to develop new management information systems.

At the present time Zayre has two IBM System 360 computers as well as an N.C.R. 315 computer. Successful management of a far-flung chain of retail department stores demands the ability to rapidly review hundreds of thousands of individual transactions, organize the information and promptly report to various levels of management so that action can be taken.

We believe that Zayre has one of the finest data processing installations in the entire retail industry ; nevertheless, we are continuing to press forward to develop improved procedures.

The IBM System 360 computers shown at right are the nerve center of a complex data processing installation.

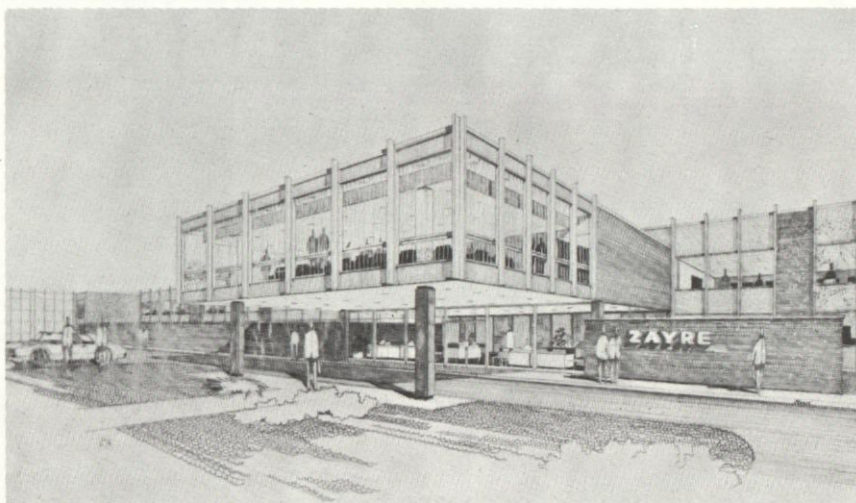


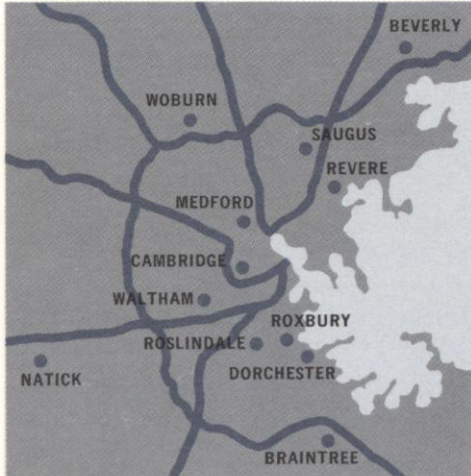
The Framingham distribution center and offices have been greatly expanded. Artist's rendering of the huge new addition is shown at right.

This facility is specially designed to handle case goods which do not require repacking. Daily shipments from this center and the two other owned facilities, as well as four public warehouses, enable the company to maintain a reliable, continuing, flow of merchandise to Zayre stores all across the nation.

The facility is adjacent to the Massachusetts Turnpike — situated to receive efficient trucking service. In addition, it has a railroad siding so that freight cars may be unloaded directly into the building.

The executive offices will be centralized and relocated at this building in May, 1967.





Boston

Home city of the Zayre operation is a typical example of the cluster approach to store location. 12 stores surround the city and provide maximum consumer impact.

Growth in Major Cities

Very early in its growth cycle Zayre decided upon the cluster approach to expanding our operation. We selected the major cities in our marketing areas as targets for developing an operating base.

Thereafter, in the years that followed, we developed this operating base by adding new Zayre stores each year. We have found that clustering a large number of Zayre stores around major cities affords many operating, advertising and merchandising economies.

Typical of our store clusters are the 9 stores operated in the Chicago area and the 12 stores operated in the Boston area. The Company expects to open 3 additional units in the Chicago area in May, 1967 bringing the total in that market to 12. In addition, 10 stores are operated in the Miami area, 5 stores in the Washington, D. C. market; 4 stores in each of the Atlanta, Indianapolis and Pittsburgh markets; and 2 or more stores in 11 other cities.

Zayre Advertising

The Zayre advertising program is basically divided into two phases, institutional or corporate image building advertising and hard-hitting price advertising.

The institutional phase of the Zayre advertising program is a well developed long range concept aimed at gaining full consumer acceptance of Zayre as a good place to shop. It is expressed through regular radio commercials as well as a continuing program of large image-type newspaper advertisements.

The price approach seeks to achieve direct customer response. It utilizes a consistent program of hard-hitting newspaper ads as well as a series of dynamic circulars for major promotional events. Today, a typical 16 page Zayre circular is distributed to millions of families living in our marketing areas.

Future Growth

Zayre is a company with ambitious plans for the future. Based upon our seasoned executive staff, as well as our over 12,000 employees, we anticipate continuing growth in the future, in both the markets already served and new markets not yet tapped. This growth will be achieved by opening additional new Zayre department stores each year.

The continuing growth of suburban areas throughout the United States will create many opportunities to open new stores. Zayre intends to take advantage of this exciting growth potential.

FINANCIAL STATEMENTS

ZAYRE CORP. AND OPERATING SUBSIDIARIES

Consolidated Balance Sheets (note A)

Assets	Jan. 28, 1967	Jan. 29, 1966
Current assets:		
Cash	\$ 6,443,796	\$ 4,226,075
U. S. Treasury bills	2,488,055	4,621,048
Accounts receivable, trade and other	3,299,822	3,660,979
Amounts due from vendors	2,462,000	1,325,000
Merchandise inventories, at the lower of cost (retail method) or market	52,802,068	40,068,399
Due from leasing subsidiaries	970,618	1,283,173
Prepaid expenses	1,647,097	1,138,697
Total current assets	<u>70,113,456</u>	<u>56,323,371</u>
Equity in wholly owned unconsolidated leasing subsidiaries (note I)	2,180,402	1,628,368
Equipment and leasehold improvements, at cost	3,937,330	3,610,761
Less accumulated depreciation and amortization	1,749,027	1,617,096
	<u>2,188,303</u>	<u>1,993,665</u>
Preopening expenses, at amortized cost (note C)	562,300	585,073
Deferred charges and other assets (note A)	2,048,113	1,797,385
	<u>\$77,092,574</u>	<u>\$62,327,862</u>
 Liabilities		
Current liabilities:		
Current instalments of general corporate debt	\$ 1,423,693	\$ 474,958
Accounts payable	20,290,864	14,547,999
Sales taxes, payroll withholdings, and collections for leased departments	1,636,647	1,686,563
Accrued expenses	4,369,204	3,160,664
Federal income taxes	4,434,262	4,003,163
Total current liabilities	<u>32,154,670</u>	<u>23,873,347</u>
General corporate debt, exclusive of current instalments (note B)	8,021,493	9,072,776
Deferred federal income taxes (note C)	126,247	73,229
Commitments (notes D and E)		
Convertible subordinated debentures		5,562,000
 Shareholders' Equity		
Preferred stock, par value \$1, authorized 1,000,000 shares		
Series A cumulative convertible preferred stock, issued and outstanding 463,636 shares (note F)	463,636	463,636
Common stock, par value \$1, authorized 7,000,000 shares, issued and outstanding 2,779,548 shares (notes F, G and H)	2,779,548	2,530,137
Additional paid-in capital	9,373,369	4,331,838
Retained earnings (notes B and F)	24,173,611	16,420,899
	<u>36,790,164</u>	<u>23,746,510</u>
	<u>\$77,092,574</u>	<u>\$62,327,862</u>

ZAYRE CORP. AND ALL SUBSIDIARIES

Consolidated Balance Sheets

Assets	<i>Jan. 28, 1967</i>	<i>Jan. 29, 1966</i>
Current assets :		
Cash	\$ 6,837,902	\$ 4,774,769
U. S. Treasury bills	2,883,114	4,621,048
Accounts receivable, trade and other	3,338,505	3,843,087
Amounts due from vendors	2,462,000	1,325,000
Merchandise inventories, at the lower of cost (retail method) or market	52,802,068	40,068,399
Prepaid expenses	1,647,097	1,138,697
Total current assets	<u>69,970,686</u>	<u>55,771,000</u>
Property, equipment and leasehold improvements, at cost :		
Land	1,740,430	1,168,096
Buildings	9,280,723	7,090,586
Leasehold improvements	3,691,495	3,041,345
Furniture, fixtures and equipment	25,844,755	20,343,393
	<u>40,557,403</u>	<u>31,643,420</u>
Less accumulated depreciation and amortization	10,020,918	7,477,087
	<u>30,536,485</u>	<u>24,166,333</u>
Preopening expenses, at amortized cost (note C)	562,300	585,073
Deferred charges and other assets (note A)	2,155,628	1,855,251
	<u>\$103,225,099</u>	<u>\$82,377,657</u>
 Liabilities		
Current liabilities :		
Current instalments of long-term debt	\$ 4,191,252	\$ 2,667,916
Accounts payable	21,104,342	14,973,816
Sales taxes, payroll withholdings, and collections for leased departments	1,636,647	1,686,563
Accrued expenses	4,585,414	3,348,117
Federal income taxes	4,442,871	4,066,563
Total current liabilities	<u>35,960,526</u>	<u>26,742,975</u>
Long-term debt, exclusive of current instalments (note B) :		
General corporate debt	8,021,493	9,072,776
Equipment promissory notes	11,045,515	8,464,550
Real estate mortgages	10,223,040	7,881,018
Deferred federal income taxes (note C)	1,184,361	907,828
Commitments (notes D and E)		
Convertible subordinated debentures		5,562,000
 Shareholders' Equity		
Preferred stock, par value \$1, authorized 1,000,000 shares		
Series A cumulative convertible preferred stock, issued and outstanding 463,636 shares (note F)	463,636	463,636
Common stock, par value \$1, authorized 7,000,000 shares, issued and outstanding 2,779,548 shares (notes F, G and H)	2,779,548	2,530,137
Additional paid-in capital	9,373,369	4,331,838
Retained earnings (notes B and F)	24,173,611	16,420,899
	<u>36,790,164</u>	<u>23,746,510</u>
	<u>\$103,225,099</u>	<u>\$82,377,657</u>

The accompanying notes are an integral part of the financial statements

ZAYRE CORP. AND ALL SUBSIDIARIES

Consolidated Statements of Income and Retained Earnings

	<i>Fiscal Year Ended</i>	
	<i>Jan. 28, 1967</i>	<i>Jan. 29, 1966</i>
Net sales, excluding sales of leased departments	\$345,702,887	\$278,558,325
Rentals from leased departments, net of estimated allocated store expenses	1,027,932	1,082,924
Other income	753,696	604,384
	<u>347,484,515</u>	<u>280,245,633</u>
Cost of sales, including buying and occupancy costs	280,070,848	226,588,931
Selling, general and administrative expenses	47,403,826	37,855,073
Depreciation and amortization	3,729,729	2,760,515
Interest expense	1,870,500	1,384,789
	<u>333,074,903</u>	<u>268,589,308</u>
Income before provision for federal income taxes	14,409,612	11,656,325
Provision for federal income taxes (note C)	6,300,000	5,000,000
Net income	8,109,612	6,656,325
Retained earnings at beginning of year	16,420,899	9,960,574
Dividends of pooled companies prior to acquisition and on preferred stock (note F)	(356,900)	(196,000)
Retained earnings at end of year	<u>\$ 24,173,611</u>	<u>\$ 16,420,899</u>

Consolidated Statements of Additional Paid-in Capital

Balance at beginning of year	\$ 4,331,838	\$ 2,823,223
Excess of cost over par value of 197,328 treasury shares changed to authorized but unissued common stock		(92,672)
Transfer to common stock account for par value of 678,693 shares distributed in seven-for-five stock split and payments in lieu of fractional shares		(682,769)
Excess of net cash proceeds over par value of common stock issued upon exercise of stock options	97,349	175,179
Excess of conversion price over par value of common stock issued in exchange for convertible subordinated debentures, net of related unamortized debt expense	5,158,622	405,297
Excess of net cash proceeds over par value of stock sold by pooled company prior to acquisition		1,703,580
Expenses incurred in connection with poolings	(240,000)	
Other credits (net) arising from pooling (note A)	25,560	
Balance at end of year	<u>\$ 9,373,369</u>	<u>\$ 4,331,838</u>

The accompanying notes are an integral part of the financial statements

ZAYRE CORP. AND ALL SUBSIDIARIES

Consolidated Statements of Funds

	Fiscal Year Ended	
Source	Jan. 28, 1967	Jan. 29, 1966
Net income	\$ 8,109,612	\$ 6,656,325
Charges to income not requiring current expenditures of funds:		
Depreciation and amortization	3,729,729	2,760,515
Deferred federal income taxes	276,000	368,000
Funds provided from operations	12,115,341	9,784,840
Net increase in long-term debt	3,871,704	9,344,806
Sale of convertible subordinated debentures (net proceeds)		5,807,860
Common stock issued upon exercise of options and conversion of debentures	5,505,382	614,644
Net proceeds from sale of stock by pooled company prior to acquisition		1,763,580
	<u>\$21,492,427</u>	<u>\$27,315,730</u>
Application		
Land and buildings	\$ 2,618,874	\$ 7,291,042
Fixtures, equipment and leasehold improvements (net additions)	6,502,640	4,757,270
Preopening costs	759,156	834,694
Deferred charges and other assets	496,815	352,990
Redemption of convertible subordinated debentures	5,562,000	438,000
Dividends, including those of pooled companies	356,900	196,000
Other	213,907	
	16,510,292	13,869,996
Increase in working capital	4,982,135	13,445,734
	<u>\$21,492,427</u>	<u>\$27,315,730</u>

The accompanying notes are an integral part of the financial statements

Auditors' Report

LYBRAND, ROSS BROS. & MONTGOMERY
CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors of Zayre Corp.:

We have examined the consolidated balance sheet of Zayre Corp. and All Subsidiaries as of January 28, 1967, the related consolidated statements of income and retained earnings and additional paid-in capital, and the consolidated statement of funds for the fiscal year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously examined and reported upon the financial statements for the fiscal year ended January 29, 1966.

In our opinion, the aforementioned financial statements present fairly the consolidated financial position of Zayre Corp. and All Subsidiaries at January 28, 1967 and January 29, 1966, the consolidated results of their operations, and the consolidated source and application of their funds for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Boston, Massachusetts
April 13, 1967

Lybrand, Ross Bros. & Montgomery

ZAYRE CORP. AND ALL SUBSIDIARIES

Notes to Consolidated Financial Statements

A — Basis of Presentation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries, all wholly owned. The consolidated balance sheets of Zayre Corp. and Operating Subsidiaries, which exclude the properties and debt of the Company's leasing subsidiaries, are presented separately for supplemental comparative purposes and the combined balance sheets of the Company's leasing subsidiaries are reflected in note I.

The Company acquired substantially all the net assets of Hardlines Distributors, Inc. on July 29, 1966 in exchange for 463,636 shares of its series A cumulative convertible preferred stock and cash of \$850,000, and substantially all the net assets of Shoppers' City, Inc. on March 31, 1967 in exchange for 129,350 shares of its common stock. The consolidated financial statements for both fiscal years give retroactive effect to these acquisitions on a "pooling of interests" basis. The foregoing \$850,000 cash payment is included in other assets on the balance sheets, net of amortization in fiscal 1967. Amortization is computed over the approximately three and one-half year period during which the federal income tax reductions expected to result from the acquisition of Hardlines Distributors, Inc. are realized. Such anticipated federal income tax reductions, net of the amortization of the cash payment, are being credited to additional paid-in capital.

B — Long-Term Debt

At January 28, 1967, long-term debt, exclusive of current instalments, consisted of the following:

General corporate debt:	
6% promissory note, payable \$60,000 semi-annually, balance due April 1, 1976	\$ 1,080,000
5.8% promissory notes, payable \$250,000 annually, balance due January 31, 1978	2,750,000
5½% subordinated notes, payable \$200,000 annually, balance due January 15, 1979	2,300,000
Promissory note, ¼% over prime, payable \$75,000 quarterly, balance due March 31, 1972	1,275,000
6½% promissory note, payable \$75,000 annually, balance due July 1, 1974	525,000
Other	91,493
	8,021,493
Equipment promissory notes, payable \$272,382 monthly including interest principally at 5% to 6%, maturing April 1, 1968 to November 1, 1975	11,045,515
Real estate mortgages, payable \$426,827 semi-annually including interest at 5½% to 6½%, maturing May 31, 1970 to January 3, 1992	10,223,040
	<u>\$29,290,048</u>

The 5½% subordinated notes are subordinated to the other general corporate debt. Under provisions of the agreements governing long-term debt, \$10,800,000 of retained earnings was available for dividends at January 28, 1967.

While the parent company is not directly obligated with respect to the equipment promissory notes or real estate mortgages, it has guaranteed the leases which have been assigned as security for such debt, and it has also agreed to provide additional financing to the real estate subsidiaries under certain circumstances.

C — Federal Income Taxes

Deferred federal income taxes arise from computing depreciation on an accelerated method for tax purposes and on the straight line method for financial reporting, and from deducting preopening expenses in the year in which a store opens for tax purposes and amortizing such expenses over a twelve month period for financial reporting. The provisions for federal income taxes include \$276,000 deferred in fiscal 1967 and \$368,000 deferred in fiscal 1966.

Investment credit used to reduce the provisions for federal income taxes amounted to \$316,000 in fiscal 1967 and \$289,000 in fiscal 1966. Approximately \$95,000 of unused investment credit is available for reduction of future taxes.

D — Commitments

Under long-term leases, expiring after fiscal 1970 (principally from 1982 to 1992), the companies are committed to pay minimum annual rentals of approximately \$10,000,000 exclusive of, in many instances, real estate taxes, insurance, maintenance and additional rentals based upon sales. Additional minimum annual rentals of approximately \$800,000 will be payable under long-term leases for stores not yet opened.

The Company has outstanding purchase commitments of approximately \$5,600,000 for real estate and leasehold improvements and \$5,000,000 for furniture, fixtures and equipment for new stores and enlarged distribution centers.

E — Retirement Plan

The actuarially determined cost of the Company's noncontributory, funded employee Retirement Plan which amounted to \$418,000 in fiscal 1967, including amortization of prior service costs over thirty years, has been charged to income.

F — Preferred Stock

The Company's series A cumulative convertible preferred stock is entitled to a liquidation preference of \$16.50 per share, or \$7,649,994 in the aggregate for the 463,636 shares issued and outstanding, and is redeemable, at the option of the Company, at the same price. Each series A preferred share is convertible into .375 shares of common stock through June 30, 1971 and into .359 shares thereafter through June 30, 1975. The Company has reserved 173,863 shares of common stock for issuance upon exercise of the conversion privilege. Dividend payments at an annual rate of \$.75 per share began to accrue as to 300,000 shares on July 29, 1966 and will begin as to the remaining 163,636 shares in January, 1968.

G — Stock Options

Under its Stock Option Plans, the Company has granted certain officers and key employees options for the purchase of common stock within five years from the grant date at option prices of 100% (1965 Plan) or 95% (1962 Plan) of market price on the grant date. Generally, all options are exercisable in four equal cumulative annual instalments commencing one year after the grant date. The 1962 Plan has been terminated except as to options outstanding thereunder. Unissued common stock reserved for options aggregated 87,710 shares at January 28, 1967 and 97,650 shares at January 29, 1966. Information concerning activity during fiscal 1967 follows:

	Option Prices	Number of Common Shares	
		Issuable under Options Granted	Available for Future Options
Outstanding at 1/29/66	\$ 7.06 to \$34.25	60,070	37,580
Options granted	\$30.50 to \$37.38	38,900	(38,900)
Options exercised	\$ 7.06 to \$21.52	(9,940)	
Cancellations		(1,590)	1,590
Outstanding at 1/28/67	\$ 7.06 to \$37.38	87,440	270

H — Stock Purchase Warrants

Class A and Class B warrants for the purchase of 87,534 and 52,489 shares, respectively, of the Company's common stock were outstanding at January 28, 1967. The price at which they are exercisable through July 15, 1971 is \$7.14 for Class A

warrants and \$8.93 for Class B warrants; thereafter both classes are exercisable at \$10.71 per share until they expire on January 15, 1979. The exercise prices and the number of shares are subject to anti-dilution provisions and adjustment for recapitalizations and similar events. The Company has reserved 140,023 shares of common stock for these warrants, none of which have been exercised.

I — Combined Balance Sheets of the Leasing Subsidiaries

	January 28, 1967	January 29, 1966
ASSETS		
Property, equipment and leasehold improvements, at cost:		
Land and buildings	\$11,021,153	\$ 8,258,682
Furniture, fixtures and leasehold improvements	25,598,920	19,773,977
	36,620,073	28,032,659
Less accumulated depreciation and amortization	8,271,891	5,859,991
	28,348,182	22,172,668
Cash and U. S. Treasury bills	789,165	548,694
Accounts receivable	38,683	182,108
Other assets	107,515	57,866
	<u>\$29,283,545</u>	<u>\$22,961,336</u>
LIABILITIES		
Long-term debt, including current instalments of \$2,767,559 in 1967 and \$2,192,958 in 1966 (note B)	\$24,036,114	\$18,538,526
Accounts payable and accrued expenses	1,038,297	676,670
Due to parent and operating subsidiaries	970,618	1,283,173
Deferred federal income taxes	1,058,114	834,599
	27,103,143	21,332,968
EQUITY	2,180,402	1,628,368
	<u>\$29,283,545</u>	<u>\$22,961,336</u>

Fixed annual rentals are payable, under long-term leases, by the parent company and its operating subsidiaries for the use of real estate, furniture, fixtures and leasehold improvements owned by the leasing subsidiaries. These leases are pledged as collateral for the related debt of the leasing subsidiaries and are directly or indirectly guaranteed by the parent company.

Board of Directors

MORRIS FELDBERG
Chairman

MAX FELDBERG
*Vice Chairman and
Executive Vice President*

ABRAM BERKOWITZ
Partner, Ropes & Gray

STANLEY H. FELDBERG
President

SUMNER L. FELDBERG
*Senior Vice President
and Treasurer*

NEWTON A. LANE
Partner, Nathanson & Rudofsky

MILTON L. LEVY
Senior Vice President

BURTON S. STERN
Senior Vice President

MORRIS NATELSON
Partner, Lehman Brothers

WALTER J. SALMON, *Associate Professor of Marketing,
Harvard Graduate School of Business Administration*

Officers

MORRIS FELDBERG
Chairman of the Board

MAX FELDBERG
*Vice Chairman of the Board
and Executive Vice President*

STANLEY H. FELDBERG
President

SUMNER L. FELDBERG
*Senior Vice President
and Treasurer*

MILTON L. LEVY
Senior Vice President

BURTON S. STERN
Senior Vice President

MAXWELL GOLDSTEIN
Vice President—Merchandising

JOEL JACOBSON
Vice President—Store Operations

PAUL KWASNICZ
*Vice President and
Assistant Treasurer*

ANNA GOLDSTEIN LEVITMAN
Vice President—Merchandising

SAUL LEIBOW
Vice President—Housewares

J. CLIFFORD LOWETH
Vice President—Real Estate

LEO MICHELSON
Vice President—Housewares

GEORGE M. PAULSON
Vice President—Merchandising

NEWTON A. LANE
Secretary

NORMAN LENOX
*Assistant Vice President and
Assistant Secretary*

THEODORE SCHOENFELD
*Assistant Vice President—
Merchandising*

Common Stock Transfer Agents

State Street Bank and Trust Company,
Boston, Massachusetts

Irving Trust Company,
New York, New York

Common Stock Registrars

The First National Bank of Boston,
Boston, Massachusetts

The Chase Manhattan Bank,
New York, New York

Preferred Stock Transfer Agent

State Street Bank and Trust Company,
Boston, Massachusetts

Common Stock Listing

New York Stock Exchange

General Counsel

Nathanson & Rudofsky

Special Counsel

Ropes & Gray

Auditors

Lybrand, Ross Bros. & Montgomery
Touche, Ross, Bailey & Smart

Distribution Centers

Framingham, Massachusetts
Natick, Massachusetts
New York, New York

Annual Meeting

The 1967 annual meeting will be held at 11:00 A.M. on Tuesday, June 6, 1967, in the Forum Room, State Street Bank and Trust Company, 225 Franklin Street, Boston, Massachusetts.

ZAYRE CORP. One Mercer Road, Natick, Massachusetts